Legacy

Annual Report 1985

Legacy Petroleum Ltd.

Corporate Data:

Date Incorporated:
October 14, 1970

Incorporated In:
Province of Alberta

Date Continued:
February 11, 1983

Predecessor Companies:
Francis Creek Mines Ltd. (NPL)
October 14, 1970 to June 14, 1971

Frances Creek Mines Ltd. (NPL)
June 14, 1971 to September 9, 1975

Cal-West Petroleums Ltd. (NPL)
September 9, 1975 to May 24, 1985

Head Office:
Suite 530, First Alberta Place
777 - 8th Ave. S.W.,
Calgary, Alberta, Canada
T2P 3R5
(403) 264-4254

Wholly-owned Subsidiaries:
Legacy Oil & Gas Ltd.
Legacy Oil & Gas, Inc.
Benchlands Oil & Gas Inc.
Harkor Developments Ltd.

Directors:
Murray F. Craig
David J. Hignett
William Y. Kennedy
Carol A. Mossfeldt
A. Kenneth Mossfeldt
Warren Shepard

Officers:
A. Kenneth Mossfeldt
President

Carol A. Mossfeldt
Secretary-Treasurer

Transfer Agent and Registrar:
The Canada Trust Company,
505 - 3rd St. S.W.,
Calgary, Alberta T2P 3Y8

Auditors:
Devonshire Smith Preston,
Chartered Accountants,
Calgary, Alberta.

Canadian Solicitors:
Korman & Co.,
Calgary, Alberta

Hogan & Webber,
Vancouver, British Columbia.

U.S. Solicitors:
James R. Learned,
Attorney at Law,
Cheyenne, Wyoming.

Robert C. Balsam,
Attorney at Law,
Billings, Montana.

Canadian Banking Connection:
Heritage Savings & Trust Company,
Calgary, Alberta.

U.S. Banking Connections:
First State Bank of Shelby,
Shelby, Montana.

Montana Bank of Billings,
Billings, Montana.

Stock Exchange Affiliation:
Alberta Stock Exchange,
Calgary, Alberta.

Year End:
May 31

Trading Symbol:
LCY-A

**Share Type/
Capitalization/
Issued and Outstanding:**
Class "A" Voting Common Shares
unlimited
2,182,898

Class "B" Non-Voting Common Shares
unlimited
nil

Preferred Shares
500,000
nil

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President's Message:

To Our Shareholders:

On behalf of the Board of Directors, I am pleased to report on the results of Legacy Petroleum Ltd. for the year ended May 31, 1985. As many of you are aware, this past year has witnessed a slow but progressive turn around. The unmanageable bank debt, costly lease inventory in the U.S., and a source of income dependent on management's ability to sell oil and gas properties in a depressed market set your Company back considerably. However, we are satisfied to report that we are a surviving junior entity, with a manageable bank debt, a much pared down and strategically situated lease spread in the State of Montana, a small but productive lease base in Canada which, hopefully, will be the genesis of our future cash flow which is expected to increase significantly during the remainder of the year.

Perhaps the most significant events during the past year, were the settlement of a near million dollar debt with the Bank of Montreal for 10% of the Company's then issued and outstanding share capital, the Company's most recent acquisition of a 50% interest in a gasplant, related facilities and 12,320 gross acres in the Halkirk region of central Alberta, announced September 16, 1985, and the company's varying interests in a 680 acre oil play in the Browning-Steelman region of southeastern Saskatchewan. Todate two oilwells have been drilled on the acreage at no cost to the Company, and a third potential location is expected to be drilled in the near future, again at no cost to the Company. More details on this area of activity are found on page two of this Annual Report.

Keeping the proceeding in mind, it is now time for the Company to take another step forward! However, for this to take place the Board of Directors needs the backing of its shareholders. For this reason we are making a formal "Rights Offering" to all shareholders. The degree of future growth will be to a large extent dependent on the participation of shareholders in this "Offering".

Your Board of Directors are very aware that many of its shareholders own a very minimal number of shares, perhaps too insignificant and costly for shareholders to even consider selling in the market place. However, the enclosed "Rights Offering" gives all shareholders with less than 500 shares of Legacy Petroleum Ltd. special consideration by way of a right to acquire up to 500 shares at 30 cents per share, or a "Board Lot", without paying commission or surcharge.

For each four shares acquired by exercising your Rights you will receive a Warrant, or an option to purchase additional shares during the next year at 50 cents per share.

We feel very strongly about this "Rights Offering" and the need for participation from our Shareholders. This is your Company, and while in the past you may have considered your investment "too small to matter", we assure you that we need the participation of each and every shareholder to succeed! If Legacy is to have the future that its current Management is both capable of and dedicated to bringing it, then we must pull together!

My special thanks goes to our Shareholders for bearing with us during the difficult past three years and a very special thanks goes out to Murray Craig, a superb friend and Director and to my wife Carol who "picked up the reins" with me when we couldn't afford to pay staff to assist us.

A. Kenneth Mossfeldt,
PRESIDENT

Future Potential Highlights:

During the balance of 1985 your Company will direct its efforts to putting together deals and prospects with little or no cost to the Company. Earlier this year the Company was able to obtain a favourable farmout arrangement in the North Steelman region of southeastern Saskatchewan.

Subsequently we entered into a farmout agreement with Lasmo Exploration (Canada) Ltd., which resulted in an oil discovery in the Frobisher formation in this NORTH STEELMAN PROSPECT. This earned the Company a 12.5% working interest in 480 acres, at no cost to the Company. We then participated in the purchase of the offsetting half section to the west at a cost of $11,638 for its 12.5% interest. These funds were raised with our U.S. Banking connection from a pledge to the Bank of the President's personal shares.

This lease was in turn farmed out to Macedon Resources Ltd., which resulted in another Frobisher oilwell. At time of writing this well was being placed on production and it is anticipated that it will be a good well. Although the Company's interest in this lease is reduced to 6.25% we expect the cash flow to be very beneficial to future growth of the Company.

In any event it was gratifying that the first prospects entered into in Canada were at no cost to the Company and better yet resulted in two producing oilwells with a possible upside of three more. Should the operators elect to apply for 80 acre spacing and succeed with their application this figure could double.

This, then, is more reason to raise cash for the Treasury on our "Rights Offering" — for the purpose of participating — and not watering down our current interest in this prospect further.

As well, we are constantly searching for companies to merge with to enhance a constant growth ethic that will manifest itself with the proper ingredients, that dovetail with the Company.

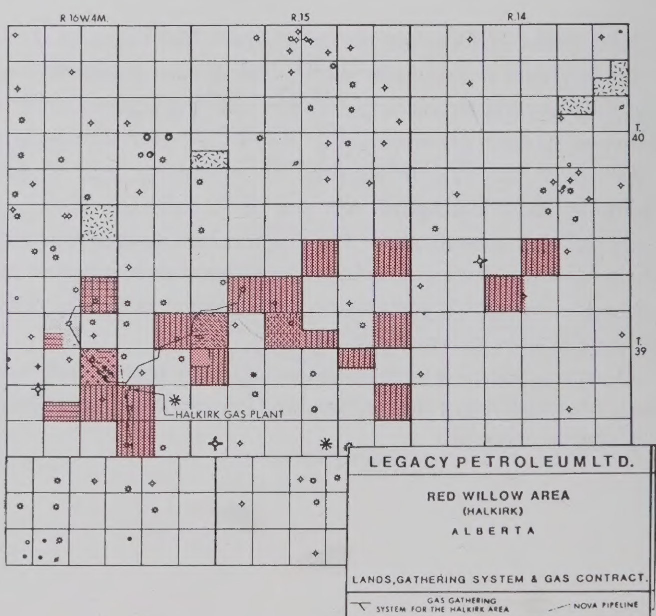
The Company is negotiating the purchase of assets with an American firm in Montana that has an attractive cash flow with minimal overhead. Our offer was considered in principal, but until the terms are completely agreed to we prefer not to elaborate. In any event this information will be forthcoming in either a press release or our next quarterly report.

Exploration & Development:

CANADA

One of the Company's main objectives is to increase exploration and development in Western Canada. The Company will continue to govern itself as in the past — through low or no cost prospects generated from within.

ALBERTA



The Company on September 12, 1985 signed an agreement to purchase 50% working interest from Merland Explorations Limited in a gasplant, related facilities and all of its lands in the HALKIRK region of central Alberta, some twenty-seven miles east of Stettler. The new acquisition, to be operated by your Company, was acquired for an undisclosed consideration to be paid in First Preferred Shares of Legacy.

The acquisition includes the gas processing facilities, seven producing wells, two wells waiting to be tied into production and some 12,320 gross acres of petroleum and natural gas leases. The acreage spread includes 5,760 acres with production from the Viking Sand and Basal Quartz zones, and 5,120 acres of undeveloped multi-zone hydrocarbon potential. In addition, the gasplant has fifteen years remaining on its contract term with TransCanada Pipelines for 2.5 MMCF/day with a maximum plant capacity of 3.5 MMCF/d.

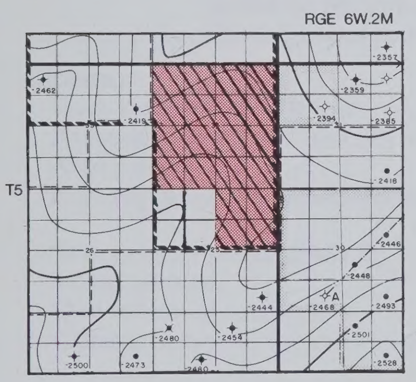
While the plant is currently producing at less than contract volumes, it is anticipated that cash flow to the Company will be approximately $150,000 per year. However, it should be further noted that the Company fully intends to develop, either directly or indirectly, the undrilled acreage required to increase volume to contract levels.

BRITISH COLUMBIA

Granite Creek Placer Gold Mine

Unfortunately the downturn in the gold market has affected our prospect northwest of Princeton, British Columbia. We suspect that by early next year we will have operations resumed and cash flow generated from this prospect. Kensington Holdings is the current opcrator of the GRANITE CREEK PROSPECT and once they have achieved payout, your Company's interest will be reduced to 20% in the four leases contained within the prospect.

SASKATCHEWAN



North Steelman

The Company has varying interests in 680 gross acres in this the NORTH STEELMAN PROSPECT. During the year Lasmo Exploration (Canada) Ltd. drilled a well on a farmout from Legacy and partners in 7-36-5-6W2M. this 1,391 metre venture originally swabbed in the Frobisher at 80 barrels of oil per day. Production has dropped to 7 barrels of oil per day. The well may be reworked if the oil to water ratio does not improve. The Company's interest in this farmout will be 12.5% interest after payout.

Weir Hill

The Company and partners agreed to a farmout/option agreement on the West half of Section 36. The farmee's well Macedon et al Weir Hill 5-36-5-6W2 indicated very favorable oil results on drillstem test of the Frobisher formation. It is expected to go on production on or before October 1, 1985. It is understood that Macedon will elect to drill their option well in the northwest quarter of the farmout acreage after further testing and evaluation of the 5-36 well. Your Company's interest in this farmout will be 6.25% after payout.

UNITED STATES

The Company currently owns varying working interests from 25 to 100% in 19,714.55 gross acres in Montana. The Company also retains gross overriding royalties in approximately 195,000 acres varying from 1.0% to 5.0% on leases in Wyoming and Montana with the vast majority located in Montana.

MONTANA

Despite the large losses suffered in Montana the Company feels it has retained the most attractive prospects for either future drilling or farmout potential.

Sweetgrass County

The Six-Shooter Dome prospect contains 323.56 gross acres. The Company owns 100% interest. This prospect is favourably placed on the Huntley Lake Basin Fault zone, east of Billings about 70 miles. In addition it is situated between two small gas fields and one mile south of an oil discovery in the Telegraph Creek formation in the Upper Cretaceous.

Fallon County

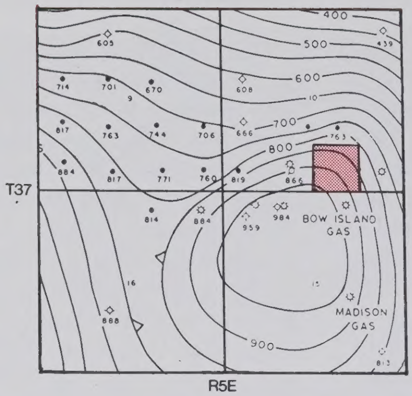
This 13,081.48 gross acre prospect is 25% owned by the Company. This prospect is favourably situated within the defined field limits of the Plevna gasfield and on the west flank of the Cedar Creek Anticline in the Williston Basin. It is determined that development of the shallow gas would not be economic. Most recently Shell Western has drilled four successful Ordovician Red River oil discoveries with varying rates as high as 128 barrels of oil per day. Cost of drilling would be far to extravegant a committment for your Company, but it is hoped that we will someday be approached for a farmout.

Petroleum County

The Company retains a 100% working interest in 3,629.51 gross acres favourably placed between recent oil discoveries by Champlin Petroleum Company to the south and the famous Cat Creek oilfield to the north. The Company has gross overriding royalty interests in 167,000 acres in the area. Most recently Black Eagle licenced two tests on a tract the Company sold them in 1982. One is scheduled as a Cambrian test, the other a Cretaceous test. In the Rattlesnake Butte area, Champlin has offset leases sold to them by the Company and have reported five and possibly seven oil discoveries. Understandably, the wells are being held "tight" until future development and acquisitions can be completed.

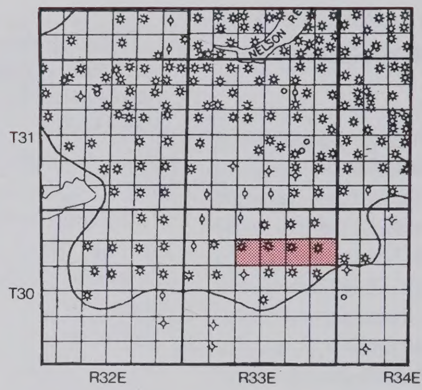
Hill County

The Company owns a 50% interest in an 80 gross acre lease situated on a known geological structure directly offsetting gas production, called the CHAIN LAKES PROSPECT. A farmout arrangement to J. Burns Brown was terminated and should an arrangement to drill not be completed with another party the company may drill this relatively inexpensive prospect early in 1986.



Liberty County

The Company owns 50% interest in a 40 gross acre lease situated on a known geological structure within the Whitlash field. This lease is offset by both oil and gas production.



Phillips County

The Company controls a 50% working interest in 2,560 gross acres situated within the Bowdoin Dome Field. Although this prospect is favourably situated just south of the Canadian border we have not been in the financial position to re-evalute the gas bearing sands through air drilling offsetting the four suspended gaswells on our leases.

Auditors' Report

To the Shareholders

Legacy Petroleum Ltd.

(Formerly Cal-West Petroleums Ltd. (N.P.L.))

We have examined the consolidated balance sheet of Legacy Petroleum Ltd. (formerly Cal-West Petroleums Ltd) (N.P.L.)) as at May 31, 1985 and the consolidated statements of loss, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at May 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The comparative figures used in these financial statements were reported on by other Chartered Accountants.

CALGARY, Alberta
July 29, 1985 and
October 9, 1985
as to Notes 2, 3 and 13

Devonshire Smith Preston

CHARTERED ACCOUNTANTS

Consolidated Balance Sheet

Legacy Petroleum Ltd.

(Formerly Cal-West Petroleums Ltd. (N.P.L.))

May 31, 1985

ASSETS

	1985	1984 (Notes 3 and 12)
Current		
Cash	$ 1,353	$ —
Accounts receivable	43,002	120,722
Oil and gas properties held for resale	14,680	556,513
Current portion of notes receivable	2,125	2,125
	61,160	679,360
Investment	—	15,000
Notes Receivable (Notes 2 and 3)	569,281	571,406
Property and Equipment		
Mineral properties (Note 4)	591,607	766,607
Oil and gas properties	83,531	230,699
Other	12,885	12,885
	688,023	1,010,191
Accumulated depreciation	7,159	5,758
	680,864	1,004,433
Other	—	1,156
	$ 1,311,305	$ 2,271,355

LIABILITIES

	1985	1984
Current		
Bank indebtedness (Note 5)	$ 19,368	$ 1,061,527
Accounts payable and accrued liabilities	75,132	130,149
Note payable	4,875	—
Current portion of promissory notes payable to officer and director (Note 7)	33,000	—
Due to shareholders (Note 6)	35,813	229,869
Loans payable	—	36,092
Due to related company	—	5,137
Current portion of long-term debt (Note 8)	78,255	—
	246,443	1,462,774
Bonus Payable to Officer and Director Due December 31, 1995 (Notes 2 and 3)	391,000	391,000
Promissory Notes Payable to Officer and Director (Note 7)	129,457	—
Long-Term Debt (Note 8)	27,600	—

SHAREHOLDERS' EQUITY

	1985	1984
Capital Stock (Note 9)		
Authorized		
Unlimited Class A voting common shares		
Unlimited Class B common non-voting shares		
500,000 Preferred shares		
Issued — 2,182,898 Class A voting shares (1984 — 8,875,382)	2,915,023	2,712,426
Deficit	(2,398,218)	(2,294,845)
	516,805	417,581
	$ 1,311,305	$ 2,271,355

APPROVED ON BEHALF OF THE BOARD

K. [signature] Director

M. [signature] Director

Consolidated Statement of Loss

Legacy Petroleum Ltd.

(Formerly Cal-West Petroleums Ltd. (N.P.L.))

Year Ended May 31, 1985

	1985	1984
		(Note 12)
Revenue		
Sale of leases	$ 246,973	$ 110,296
Cost of leases	468,256	407,196
	(221,283)	(296,900)
Other	28,167	9,996
	(193,116)	(286,904)
Expenses		
Interest on long-term debt	8,294	—
General and administrative	299,334	285,870
Commissions	27,255	—
Depreciation	1,400	1,418
	336,283	287,288
Loss from Operations	(529,399)	(574,192)
Oil and gas properties surrendered	256,854	—
Write-down of oil and gas properties held for resale	—	1,327,821
Mining property surrendered	175,000	—
Surrender of shares in Sioux Minerals, Inc.	—	36,176
Loss Before Income Taxes and Extraordinary Items	(961,253)	(1,938,189)
Income Taxes	208,416	—
Loss Before Extraordinary Items	(1,169,669)	(1,938,189)
Extraordinary Items		
Gain on settlement of debt net of applicable income taxes of $ 82,140	726,131	—
Write-off of amounts due to previous shareholders	48,325	—
Recovery of income taxes due to application of prior year losses	291,840	—
	1,066,296	—
Loss	$(103,373)	$(1,938,189)

	1985	1984
Earnings (Loss) Per Common Share		
Before extraordinary items	$(0.58)	$(1.21)
Extraordinary items	0.53	—
Including Extraordinary Items	$(0.05)	$(1.21)

Consolidated Statement of Deficit

Legacy Petroleum Ltd.

(Formerly Cal-West Petroleums Ltd. (N.P.L.))

Year Ended May 31, 1985

	1985	1984
		(Note 12)
Deficit, Beginning of Year		
As previously stated	$ (2,309,696)	$(356,656)
Foreign exchange gain charged to earnings (Note 12)	14,851	—
As restated	(2,294,845)	(356,656)
Loss	(103,373)	(1,938,189)
Deficit, End of Year	$(2,398,218)	$(2,294,845)

Consolidated Statement of Changes in Financial Position

Legacy Petroleum Ltd.

(Formerly Cal-West Petroleums Ltd. (N.P.L.))

Year Ended May 31, 1985

	1985	1984
Working Capital was Provided by		(Note 12)
Common shares issued		
For cash	$ —	$ 82,239
For purchased subsidiary	—	990,003
For settlement of accounts payable	30,857	23,310
For settlement of bank loan	88,445	—
For notes receivable	—	152,531
For settlement of notes payable	71,295	—
For services	12,000	—
	202,597	1,248,083
Reclassification of oil and gas leases to leases held for resale	—	256,193
Repayment of notes receivable	2,125	—
Reclassification of investment to current assets	15,000	—
Recovery of income taxes due to application of loss carryforward	22,300	—
Gain on settlement of debt previous	808,271	—
Write-off of amounts due to shareholders	48,325	—
Proceeds of long-term debt	85,966	—
Promissory notes payable to officer and director	162,457	—
	1,347,041	1,504,276
Working Capital was Used for		
Operations	643,304	1,005,126
Investment in acquired subsidiary, net of working capital acquired of $ 3471	—	986,532
Property and Equipment additions	14,240	25,287
Notes receivable	—	151,006
Repayment of long-term debt including change in current portion	58,366	—
Repayment of notes payable to officer and director including change in current portion	33,000	—
	748,910	2,167,951
Increase (Decrease) in Working Captial	598,131	(663,675)
Working Capital Deficiency, Beginning of Year	(783,414)	(119,739)
Working Capital Deficiency, End of Year	$(185,283)	$(783,414)

Notes to Consolidated Financial Statements

Legacy Petroleum Ltd.

(Formerly Cal-West Petroleums Ltd. (N.P.L.))
May 31, 1985

1. ACCOUNTING POLICIES

a) Principles of Consolidation

The consolidated financial statements include the accounts of Legacy Petroleum Ltd. and its wholly-owned subsidiaries, Harkor Developments Ltd., and Legacy Oil & Gas Ltd. and its wholly-owned subsidiaries, Legacy Oil & Gas, Inc. and Benchlands Oil & Gas, Inc.

The acquisitions of the subsidiary companies have been accounted for by the purchase method, and accordingly, earnings or losses since the dates of acquisition are included in the consolidated statement of loss and deficit.

The excess of consideration paid for the shares of the subsidiary companies over the book value of their net assets at dates of acquisition has been included in mineral properties and oil and gas properties held for resale in the consolidated financial statements and has been amortized or written off on the same basis as such assets.

b) Property and Equipment

i) Oil and Gas Properties

The Company follows the full cost method of accounting whereby all costs of exploring for and developing oil, gas and related reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges on non-producing property, costs of drilling both productive and non-productive wells, and overhead expenses related to exploration activities. A separate cost centre is established for each country in which the Company operates, at present Canada and the United States. Costs accumulated are limited to the lower of costs or the present value of estimated future net revenues from production of the underlying reserves. These costs will be amortized on the unit of production method based on estimated reserves upon commencement of production.

All of the Company's exploration and development activities related to oil and gas are conducted with others; accordingly, the accounts reflect only the Company's proportionate interest in such activities.

ii) Mineral Properties

Acquisition and deferred exploration and development costs are capitalized on an area of interest basis. These expenditures will be charged against income when properties are developed to the stage of commercial production through unit of production depletion. Accumulated costs related to an area of interest are charged to earnings if the property is sold or abandoned.

The amounts shown for mineral properties represent costs to date and do not necessarily reflect present or future values.

Development of mineral properties and recovery of related costs are dependent upon capital financing arrangements, mineral market conditions, environment considerations and general economic conditions.

iii) Other

Other equipment is stated at cost and is depreciated on the declining balance basis at an annual rate of 20%.

c) Foreign Currency Translation

The Company uses the temporal method for the translation of foreign currency. Under this method, monetary assets and liabilities are translated at the exchange rate prevailing at the balance sheet date. Non-monetary assets and liabilities and operations are translated at the exchange rates in effect at the date of the transaction. Foreign exchange gains and losses are included in earnings except for unrealized gains and losses relating to long-term debt which are deferred and amortized over the remaining life of the debt.

2. NOTES RECEIVABLE

	1985	1984
Notes receivable due December 31, 1995 (See Note 3)	$ 391,000	$ 391,000
Notes receivable due October, 1990, repayable in annual instalments of $ 1,525 to May 31, 1990 with the balance of $ 143,381 due, $ 116,811 July 1, 1990 and $ 36,570 October 1990	151,006	152,531
Notes receivable due December, 1995, repayable in annual instalments of $ 600 to May 31, 1994 with the balance of $ 23,700 due, $ 12,000 June, 1994 and $ 11,700 December, 1995	29,400	30,000
	571,406	573,531
Current portion	2,125	2,125
	$ 569,281	$ 571,406

The notes receivable are non-interest bearing and are due from present and former officers and directors of the Company.

3. MATERIAL CONTRACTS

In September, 1985 management became aware of a series of actions in Legacy Oil & Gas Ltd. ("Legacy Ltd") one of which contravened the Alberta Business Corporations Act. These actions occurred prior to acquisition of Legacy by the Company on September 6, 1983.

On September 2, 1983 a series of directors' resolutions provided the following:

a) Rescinded the directors' resolutions of August 30, 1983, which had established, pursuant to an employment contract with the President dated November 28, 1980 (revised June 15, 1983), a management bonus of $ 400,000.

b) Rescinded the directors' resolutions of August 30, 1983 which applied $ 391,000 of the management bonus to the balance of promissory notes.

c) Forgave the balance of $ 391,000 of the promissory notes.

d) Resolved that no management bonus pursuant to the employment contract noted in (a) above be declared.

In order to remedy the contravention and on the advice of legal counsel, the directors, by a series of resolutions dated September 30, 1985, provided the following:

a) Rescinded the directors' resolution of September 2, 1983 which forgave the balance of the promissory notes receivable of $ 391,000.

b) Rescinded the directors' resolutions of September 2, 1983 which resolved that no management bonus pursuant to the employment contract be declared.

c) Reinstated the $ 400,000 management bonus originally declared August 30, 1983 to be payable to the President of the Company by December 31, 1995.

d) Reinstated the promissory notes due to Legacy Ltd. from the President of the Company and extended the due date to December 31, 1995.

Management has recorded the reinstatement of the promissory notes receivable and the bonus payable, net of amounts applied to promissory notes ($ 9,000) payable by the President to Legacy Ltd., as prior period adjustments in Legacy Ltd. prior to acquisition on the basis that the intent of management had been that there was an implicit interrelationship between the promissory notes and the bonus payable.

4. MINERAL PROPERTIES

	1985	1984
Canada		
Acquisition costs	$ 188,031	$ 188,031
Deferred exploration and development costs	403,576	403,576
	591,607	591,607
United States		
Acquisition costs	—	175,000
	$ 591,607	$ 766,607

The Company's 100% interest in four placer leases at Granite Creek, British Columbia has been farmed out to Kensington Holdings Ltd. ("Kensington"). The Company's interest will revert to a 20% carried interest when Kensington has recovered its exploration and capital equipment expenditures which, at May 31, 1985, has not occured.

5. BANK INDEBTEDNESS

	1985	1984
Bank overdraft	$ —	$ 12,622
Bank loan in Canadian funds	19,368	28,557
U.S. $ Bank loans (U.S. $ 788,157)	—	1,020,348
	$ 19,368	$ 1,061,527

The loan in Canadian funds bears interest at the prime rate plus 1% and is secured by assets of the President of the Company.
During the year, the Company negotiated the settlement of a loan of $ 896,716 (U.S. $ 684,516) in principal and unpaid interest by the issue of 884,448 shares of the Company with a market value of $ 88,445. This settlement resulted in a gain of $ 808,271 which has been disclosed in the statement of loss as an extraordinary item.

6. DUE TO SHAREHOLDERS

The amounts due to shareholders are unsecured, are either non-interest bearing or bear interest at rates ranging from 15% to 17.75% and are due on demand.

7. PROMISSORY NOTES PAYABLE TO OFFICER AND DIRECTOR

	1985	1984
Promissory note, payable to A. K. Mossfeldt, repayable in annual instalments of $ 8,000 on December 31, 1985 to 1988, and $ 7,250 on December 31, 1989	$ 39,250	$ —
Promissory note, payable to A. K. Mossfeldt, repayable in annual instalments of $ 25,000 on December 31, 1985 to 1988, and $ 23,207 on December 31, 1989	123,207	—
	162,457	—
Current portion	33,000	—
	$ 129,457	$ —

8. LONG-TERM DEBT

	1985	1984
U.S. Bank loan (U.S. $ 16,982) at 14.5% due April 1, 1986 repayable in monthly instalments of U.S. $ 1,000 principal and interest with the balance due April 15, 1986	$ 23,321	$ —
U.S. Bank loan (U.S. $ 60,098) bearing interest at prime plus 1%, due September 30, 1986 repayable U.S. $ 20,000 on September 30, 1985 and March 31, 1986 with the balance on September 30, 1986, secured by assets of the President of the Company	$ 82,534	—
	105,855	—
Current portion	78,255	—
	$ 27,600	$ —

9. CAPITAL STOCK

a) **Authorized**

Pursuant to a shareholders' resolution dated May 15, 1985, the shareholders approved and implemented the following changes in the authorized and issued share capital:

i) Decreased the issued share capital to 2,182,898 common shares by converting the issued common shares on the basis of 5 shares for each new share (designated as Class A voting common share).

ii) Increased authorized share capital by the creation of an additional class of an unlimited number of Class B common non-voting shares.

iii) Increased authorized share capital by the creation of 500,000 preferred shares. The rights of these shares shall be determined and designated at time of issue (see Note 13).

b) **Issued**

Changes in the issued Class A voting shares during the year are as follows:

	1985		1984	
	Number of Shares	**Stated Value**	**Number of Shares**	**Stated Value**
Balance, beginning of year	8,875,382	$ 2,712,426	4,766,583	$ 1,464,343
Issue of shares for cash	—	—	274,130	82,239
Issue of shares for notes receivable from present and former directors	—	—	476,660	152,531
Issue of shares for shares of subsidiary company	—	—	3,300,009	990,003
Issue of shares in settlement of accounts payable	321,710	30,857	58,000	23,310
Issue of shares in settlement of bank loan	884,448	88,445	—	—
Issue of shares in settlement of note payable to director	712,948	71,295	—	—
Issue of shares for services rendered by former director	120,000	12,000	—	—
	10,914,488	2,915,023	8,875,382	2,712,426
Conversion adjustment pursuant to shareholders' resolution (Note 9 (a) (i))	(8,731,590)	—	—	—
	2,182,898	$ 2,915,023	8,875,382	$ 2,712,426

c) **Shares Reserved**

As at May 31, 1985, 50,000 Class A voting common shares are reserved at an exercise price of $ 0.60 per share pursuant to terms of a share option agreement which expires October 31, 1985.

d) **Earnings Per Share**

The earnings per share are calculated using the weighted average number of shares outstanding during the respective fiscal year after giving retroactive effect to the share conversion of May 15, 1985 (Note 9 (a) (i)).

10. RELATED PARTY TRANSACTIONS

During the year, the Company was charged $ 35,500 (1984 — $ 25,000) for secretarial services by a related company and legal fees of $ 18,932 from former director of which $ 12,000 was paid by the issue of 120,000 common shares.

Additional related party transactions are outlined in Note 3.

11. INCOME TAXES

The Company has accumulated losses for Canadian income tax purposes of $ 476,292 and $ 649,294 (U.S.) for United States income tax purposes, the related benefit of which has not been recognized in the financial statements. Unless sufficient taxable income is earned by the Company, the losses for Canadian income tax purposes expire as follows:

1986	—$	10,175
1987	—$	16,418
1990	—$	43,789
1991	—$	395,509
1992	—$	10,401

The losses for United States income tax purposes will expire in 1999.

12. COMPARATIVE FIGURES

Certain of the comparative figures have been restated to conform with the presentation adopted in the current year. In addition, the loss and deficit for the year ended May 31, 1984 has been restated to reflect the foreign exchange gain of $ 14,851 on translation of Legacy Oil & Gas, Inc. as a charge to loss rather than a separate item in shareholders' equity.

13. SUBSEQUENT EVENTS

Subsequent to May 31, 1985, the Company purchased a 50% direct interest in a gas plant and facilities and related gas contracts with TransCanada Pipelines Ltd. Total purchase price is $ 250,000 with payment to be by the issuance of 25 8% First Preferred Shares, par value $ 10,000.

14. SEGMENTED INFORMATION

The Company's operations are conducted in Canada and the United States through two industry segments — the sale of oil and gas leases and mineral exploration.

	1985	1984
Industry Segments		
Sales		
Oil and gas leases	$ 246,973	$ 110,296
Operating Loss		
Oil and gas leases	$ 505,392	$ 1,624,721
Mineral exploration	175,000	—
	680,392	1,624,721
General corporate expenses, net of revenues	271,167	275,874
Interest on long-term debt	8,294	—
Depreciation	1,400	1,418
Surrender of shares in Sioux Minerals Inc.	—	36,176
Corporate taxes	208,416	—
Loss Before Extraordinary Items	$ 1,169,669	$1,938,189
Identifiable Assets		
Oil and gas leases	$ 141,213	$ 907,934
Mineral exploration	591,607	766,607
	732,820	1,674,541
Corporate	578,485	596,814
	$ 1,311,305	$ 2,271,355
Geographic Area		
Sales		
United States	$ 246,973	$ 110,296
Operating loss		
United States	$ 680,392	$ 1,624,721
Identifiable assets		
Canada	$ 603,203	$ 591,607
United States	129,617	1,082,934
	732,820	1,674.541
Corporate — Canada	578,485	596,814
	$ 1,311,305	$ 2,271,355

Corporate History:

Legacy Petroleum Ltd. was incorporated October 14, 1970 as Francis Creek Mines Ltd. (NPL), a private company. On June 14 1971, Francis Creek Mines Ltd. (NPL) changed its name to Frances Creek Mines Ltd. (NPL), a private company. On December 21, 1971 Frances Creek Mines Ltd. (NPL) became a publicly listed corporation on the Alberta Stock Exchange. In September 1975, the Corporation changed its name to Cal-West Petroleums Ltd. (NPL). In April of 1976 the Company acquired all the issued and outstanding shares of Harkor Developments Ltd., a private company, whose primary asset was a gold mining claim at Granite Creek, British Columbia. This mining claim was subsequently partially developed and remains an asset of the Corporation at this time.

Until early 1983, the Company was primarily involved in mining related activities. In March of 1983, the Company acquired petroleum and natural gas leases in the State of Montana, providing Cal-West Petroleums Ltd. (NPL) with a more diversified portfolio.

In May 1983, A. Kenneth Mossfeldt, and business associates replaced the previous management of the Company on the Board of Directors. Mr. Mossfeldt was then President of the private Calgary based Legacy Oil & Gas Ltd., and its wholly-owned subsidiaries, Legacy Oil & Gas, Inc. and Benchlands Oil & Gas Inc. In September 1983, shareholders of both Cal-West Petroleums Ltd. (NPL) and Legacy Oil & Gas Ltd. approved a share exchange whereby Cal-West acquired the 3,300,009 issued and outstanding shares of Legacy Oil & Gas Ltd. (representing 100% of the total issued and outstanding shares of Legacy) for a like number of shares of Cal-West.

In mid-May of this year Shareholders ratified a change of name from Cal-West Petroleums Ltd. (NPL) to Legacy Petroleum Ltd. Also at the May 15, 1985 Special Meeting, shareholders approved a consolidation of share capital based on five (5) of the old Cal-West shares for each one (1) of the new Legacy Shares. In addition shareholders approved the creation of a Class "B" non-voting common share, and the creation of preferred shares. The creation of additional share types reflected the Company's need to achieve greater flexibility for negotiating agreements and/or purchases which would subsequently enhance the potential for growth. No Class "B" or Preferred Shares have been issued as of the date of this report.

The Cal-West designation for the Company was delisted from the Alberta Stock Exchange and "Legacy Petroleum Ltd." was called for trading on June 26, 1985. The initial trade in the Legacy designation was made on August 21, 1985 at 35 cents per share.

PRICE RANGE AND TRADING VOLUME

Alberta Stock Exchange Designation:
Cal-West Petroleums Ltd. (NPL)-CWP-C

1984 Month	Monthly High (in Cents)	Monthly Low (in Cents)	Monthly Volume
July	9	7	62,500
August	6	5	21,300
September	10	6	42,400
October	15	10	75,500
November	17	10	52,200
December	10	6 1/2	51,000
1985			
January	7	5	105,500
February	7	5	157,500
March	8	7	90,000
April	11	5	181,500
May	8	5	102,500
June	6	6	27,000

Alberta Stock Exchange Designation:
Legacy Petroleum Ltd. -LCY-A

1985				
June	Bid: 10 cents Ask: 40 cents	—	—	360
July	Bid: 15 cents Ask: 30 cents	—	—	20

Legacy

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